

Lucas Group Partners

Unemployment Insurance Reforms

Summary of Recommendations
April 2011

Dr. William Oliver, Partner
The Lucas Group

Agenda

Purpose of this study

The UI situation in Michigan

Lucas Group recommendations

Next steps

Purpose

Purpose of the Study:

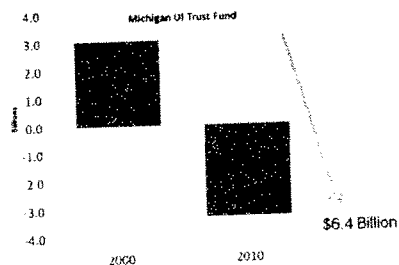
- The Chamber commissioned this study to evaluate and recommend reforms to Michigan's insolvent unemployment insurance (UI) system

Purpose of this Presentation:

- Frame the issue, outline the crisis facing Michigan's employer-financed UI system
- Identify "why" we owe \$4 billion to the federal government
- Present key legislative, administrative and policy recommendations to attack the problem – \$350-\$550 million in annual cost savings

The Situation

Michigan's employer-financed UI fund is in negative balance, down \$6.4 billion in 10 years



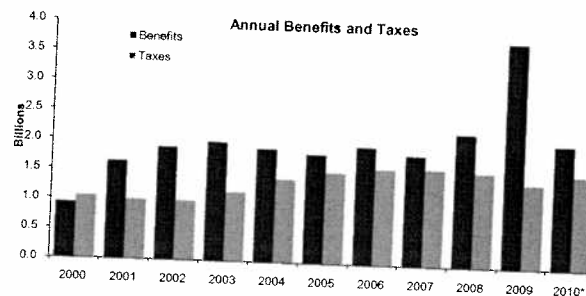
→ \$4 billion debt (April 27, 2011)

Michigan's UI debt is the highest in the nation, behind California, giving the state a "black eye"

The Situation

Michigan's high unemployment only accounts for 18% of the problem

Fund activity has been imbalanced for a decade



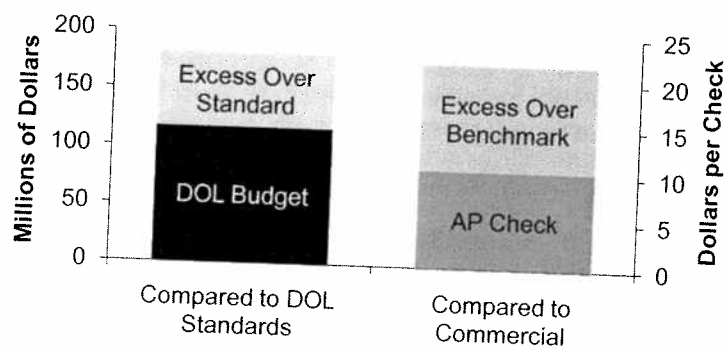
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The Situation – Cost-Drivers

Three Key Cost-Drivers Also to Blame:

1. UI program is too costly

- Program rife with fraud and overpayments
- Eligibility rules and benefit formulas are too loose, need updating
- UI program is expensive, \$64 million higher than amount budgeted by the federal government



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The Situation – Cost-Drivers

2. UI program is too slow
- Primarily an issue with the appellate system

Performance Dimension	Minimum Acceptable Performance	Current Performance
First Payment with 14* days after the end of the first compensable week	87%	84.5%
Average Age of Claims Pending Higher Authority Appeals	40 days	22% of appeals have been open 180+ days
Average Age of Claims Pending Lower Authority Appeals	30 Days	63.9% have been pending 40+ days
Nonmonetary Determination Quality — Initial Claims	75%	74%
Nonmonetary Determination Quality — On-going Claims	75%	93%

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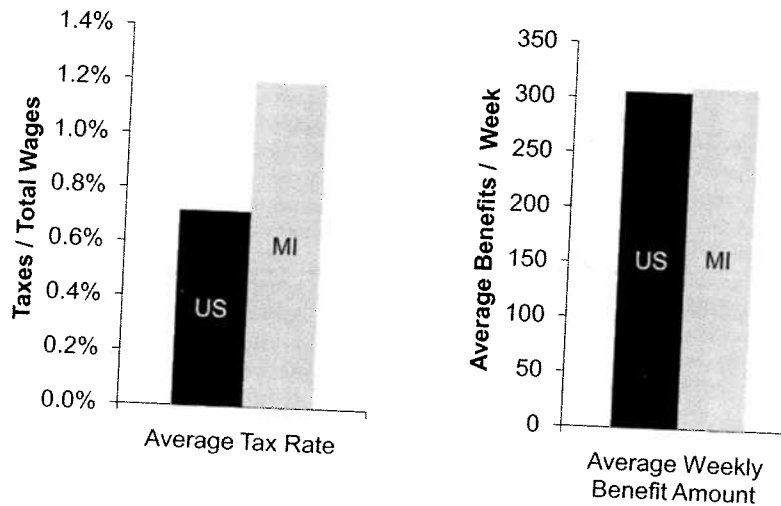
The Situation – Cost-Drivers

3. UI program is inaccurate
- MI completes a fully accurate claim only 85% of the time, resulting in fraud and overpayments
 - US DOL estimates \$438 million in waste and fraud in 2010
 - Of that, \$131 million attributable to people working while fraudulently collecting
 - UIA is currently working to collect from 208,000 claimants with overpayments
 - Overpayment = Benefit payments later determined to be invalid. These include payments made during the appeals process
 - Overpayments happen because UIA cannot meet the federal requirements for finally determining eligibility, so they "pay and chase"
 - \$640 million paid on invalid claims, with 10% of these paid in excess of \$8,000. To date, only \$83 million has been collected
 - UIA has difficulty collecting these overpayments
 - Little accountability due to automated initial and weekly certification of claims; creates potential for misuse

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UI: Growing Burden for Job Providers

UI Taxes are nearly 50% higher than the national average, even though benefits are about the same as other states



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UI: Growing Burden on Job Providers

Unless something is done, Michigan's debt will automatically trigger higher federal UI tax rates each year for the next 10 years to repay principal on the loan

Employers will also need to pay \$1 billion in interest on the UI debt over the next decade

- This amount is above regular state and federal UI taxes and the higher federal taxes
- This situation could get worse (e.g., if the debt gets worse, Michigan experiences another recession)

\$5 billion in debt and interest = \$1,400 per worker

- Note: This calculation is made for illustration purposes only

Given the size and scope of the debt, action is needed

The Lucas Group recommends key legislative and administrative changes that will begin to eliminate the debt and put the program on the road to solvency

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Major Re-engineering of UI Program Needed

Recommendation	How this will save Michigan Employers/Taxpayers	Potential for Annual Savings
Pursue fraud and abuse more proactively/aggressively	Detect and capture fraud. Michigan's recovers less than 1% of claims as fraud (nationally, recover 2%)	\$30-50 MM
Eliminate the "pay and chase" approach to claims management	Eliminate overpayments, which are instances in which UIA pays claimants benefits they never were eligible for, but takes as much as a year to resolve	\$60-80 MM
Tie UI more closely to work search activities to get claimants back to work	Michigan benefits in two ways: (1) fewer weeks of claims benefits, and (2) employees get back to work, strengthening the economy	\$30-40 MM
Revise non-monetary eligibility requirements (national best practices)	Savings found by revising seasonal worker definitions, gross misconduct, and requiring claimants to accept job offers reflective of the current job market	\$30-50 MM
Revise monetary eligibility requirements	Savings found by making fewer weekly benefit payments (waiting week)	\$80-100 MM
Implement new benefit formula (52 weeks vs. high quarter)	Savings found by implement controls to avoid benefit spiking due to seasonal or other peaks in pay	\$150-250 MM
Create a new, quality management approach to managing claims	This is fundamental to many of the other recommendations. In addition to improving quality, it should reduce cost of administration	\$50-70 MM
		\$350-550 MM

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Key Steps to Implementation

Legislative Changes

- ☐ Overhaul the appellate system to more quickly settle claims disputes
- ☐ Narrow the opportunities for claimants to take unfair advantage of the system
 - ☐ Allow more companies to be "seasonal"
 - ☐ Eliminate the "attached worker" program
 - ☐ Raise the bar on "suitable work" as the claim ages
 - ☐ Increase disqualification for employees fired for misconduct
- ☐ Implement a waiting week
- ☐ Revise benefit formula to avoid benefit spiking

Administrative Changes

- ☐ Implement commercial data mining software to find and prosecute claimant fraud and abuse
- ☐ Eliminate "pay and chase" – improve processes through continuous improvement and policy improvements to ensure that all eligibility determinations are finalized within the required 21 days

Policy Improvements (non-legislative)

- ☐ Require claimants to report more details of job search activity, sufficient to audit in a meaningful manner

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Summary

\$4 Billion in debt, plus \$1 Billion in interest will take 10 years to repay

While high unemployment is a key cause, over half of Michigan's deficit is related to shortcomings in the program itself:

- ❑ Slow
- ❑ Inaccurate
- ❑ Costly

System-wide reforms could reduce costs \$350-550 million annually

- ❑ Solvent in half the time
- ❑ Build a solid future for workers, employers and taxpayers

Policy makers need to take action – unaddressed, this problem will only get worse

Questions?

THE LUCAS GROUP

Public Policy Study to
Evaluate and Recommend Reforms
to Restore Balance to Michigan's
Unemployment Insurance Trust Fund

Prepared by:
The Lucas Group
On Behalf of:
Michigan Chamber Foundation



**MICHIGAN
CHAMBER**

Foundation

116 Huntington Avenue, Suite 504
Boston, MA 02116-5749
Main: (617) 224-1212
Fax: (617) 224-1211
www.lucasgroupinc.com
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Reforms

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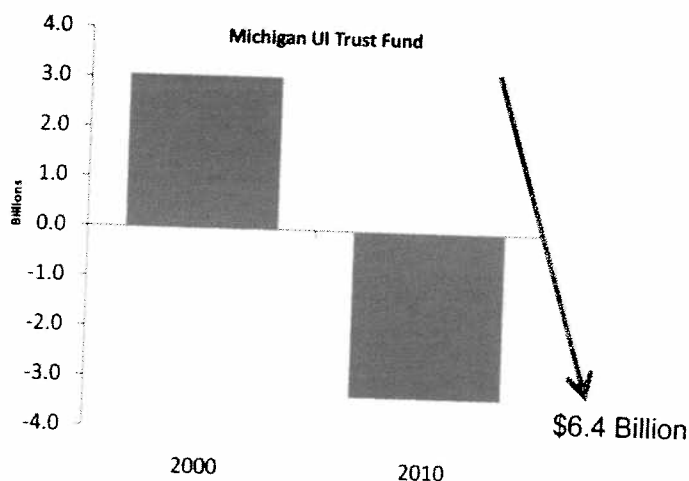
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1 Executive Summary

Michigan's employer financed Unemployment Insurance (UI) program is in crisis. The trust fund that it pays claims from is nearly \$3.8 billion in debt to the federal government as of February 2011. Additionally unemployment rates are predicted to stay well above national levels for the foreseeable future, which will trigger the need for further federal borrowing if nothing is done. The UI program's economic situation is beyond what could be expected as a result of the state's high unemployment levels. After building an adequate reserve of nearly \$3 billion before the 2002 recession, Michigan systematically drew down the fund over the following years. The state then entered the most recent recession with no reserve (Figure 1.)

Figure 1: Michigan Trust Fund Balance, 2000 and 2010

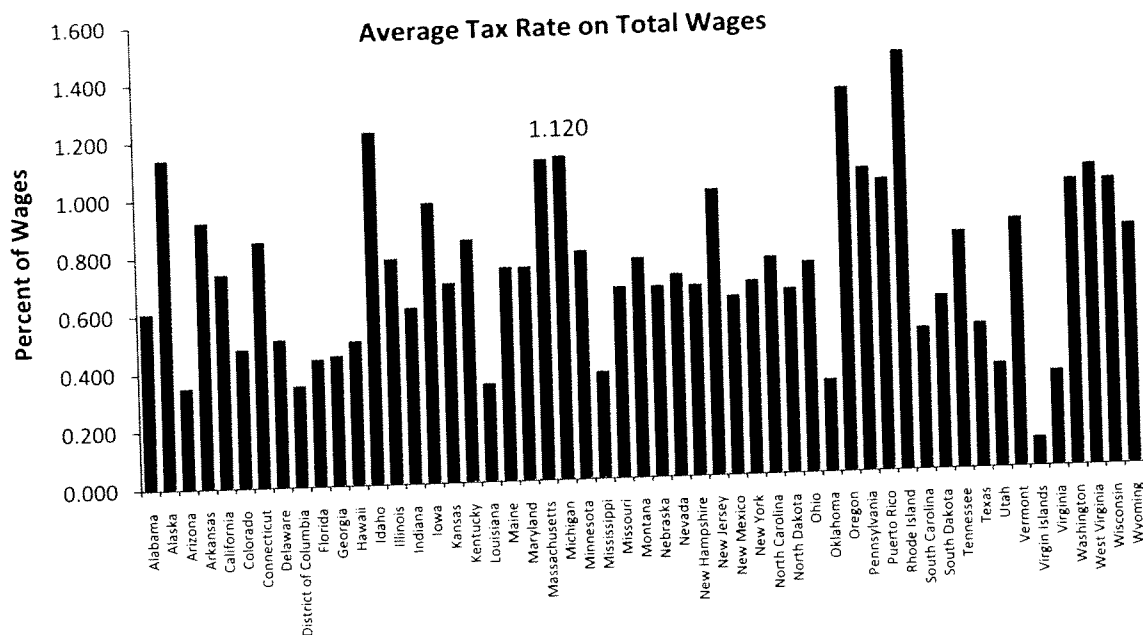


Source: The Lucas Group analysis of Department of Labor (DOL) data

As the program is currently structured and managed, it does not have the ability to recover on its own. Employer taxes are 50% higher than the national average. Michigan's high UI debt has triggered higher Federal Unemployment Tax Act (FUTA) rates that will add \$21 more tax per employee each year for the next five to ten years. Furthermore, employers will need to pay \$1 billion in interest on UI debt over the next decade, above and beyond regular UI taxes. Historically, Michigan has experienced recessions about every seven years. If this cycle were to repeat in the future, Michigan's UI fund would not be ready.

In order to understand how Michigan can rebuild its UI program, it is important to understand what drove the fund into such a huge shortfall. To peel back the onion, we need to understand three general aspects of UI: taxes, benefits and the underlying administration. First, we look at taxes. UI taxes are somewhat unique in that they are not set at a fixed rate; rather, they are calculated based on historical benefits payments incurred as a result of employees laid off from each employer. A good way to evaluate Michigan's rate is to step back from the details of tax calculation and consider average taxes paid on total (not taxable) wages, as done in Figure 2. This shows that Michigan's average rate of 1.12% is 47% higher than the US average of 0.76%.

Figure 2: Average Taxes on Total Wages, 3Q2010, All States

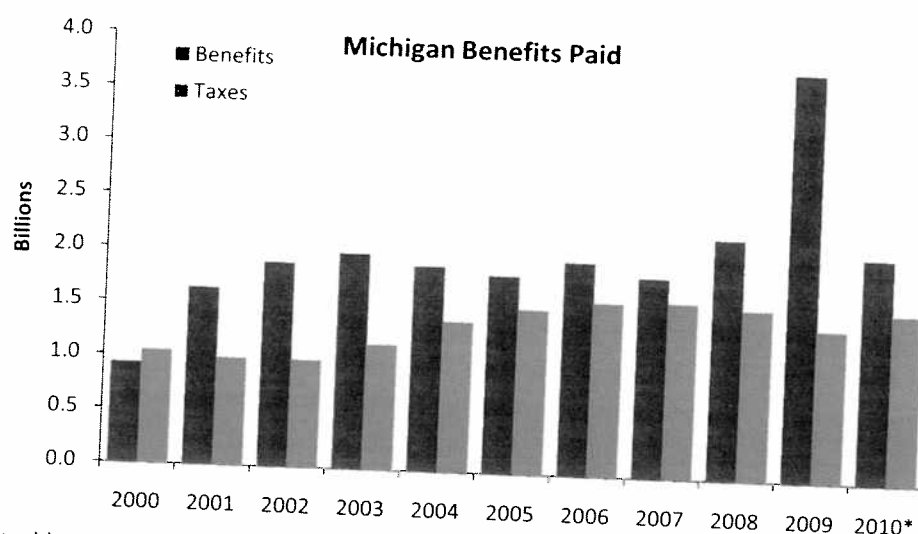


Source: Lucas Group analysis of DOL data

These high taxes are a direct result of Michigan's high unemployment rate. However, this does not explain why UI is out of money. Nationally, it is true that states with high unemployment have used up their UI trust funds. However, some other states with high unemployment (such as Nevada) have healthier trust funds at this point in the recession than Michigan. Data analysis shows that unemployment rate explains only about 18% of Michigan's UI problems. After factoring out the impact of high unemployment rate, Michigan's trust fund is still \$2.5 billion below what it should be.

UI rates are designed to make sure that over the long run there is enough to meet claim obligations. Instead, Michigan paid more in benefits than it collected in taxes every year since 2000 (Figure 3). This caused Michigan to enter the 2008-2009 recession with no reserves.

Figure 3: Total Michigan Benefits Paid: State-Only, 2000-2010



* 2010 estimated by using 4Q2009

Source: Lucas Group analysis of DOL data

Thus, we look second at whether high benefits are the problem. Michigan benefits are about the same as other states. Like taxes, benefits are established by a complicated calculation. Netting out the complexity can (again) be done by noting that Michigan's average weekly benefit amount (AWBA) of \$311 is about the same as the \$306 US median (maximum weekly benefit is \$362). Another convenient method of comparing is coverage ratio (AWBA/average wage). On this metric, Michigan is likewise the same as the US median, and has stayed within a few percent over the past decade.

Since Michigan taxes are high and benefit rates are not above average, we look to the third possibility: that administrative issues could explain how Michigan developed the highest trust fund shortfall (adjusted for state size).

There is substantial room for improvement in the manner by which benefits are administered. Michigan should immediately undertake a series of reforms to improve performance of the program. This is critical to ensuring that Michigan's UI system is able to provide an adequate level of benefits to employees who are temporarily unemployed through no fault of their own and keep UI costs affordable for employers and competitive with other states.

Michigan's UI program is costly, \$64 million higher than the amount allocated by the federal Department of Labor (DOL) allocation for the state. Michigan's performance standards are lower than the average for other US UI agencies. The program is slow. When a claim is challenged on appeal, 22% of the time, the current 26 week state maximum claim duration is exhausted before the appeal is resolved. The program is inaccurate. Using Unemployment Insurance Agency's (UIA) own quality metrics, Michigan completes a fully accurate claim only 85% of the time, not even meeting the Agency's own meager goal of 87% accuracy.

The Lucas Group recommends that Michigan undertake a fundamental reengineering of the UI administration process. Michigan's UIA performs similarly UI agencies in other states. However, these

do not provide an adequate benchmark. As an industry, UI transaction processing has not embraced management practices adopted by their client employers decades ago. Instead, Lucas Group evaluated UIA against other transaction processing organizations that perform similar functions, other types of organizations that establish and verify initial and on-going eligibility, then process large numbers of transactions. UIA performs a function comparable to an accounts payable (AP) department, auto or home loan creation and servicing, and even state Medicaid administration. With its scale (8 million checks issued in 2010), UIA has the opportunity to be one of the most efficient transaction processors in Michigan. Instead, processing a claim costs \$20 in Michigan, compared to \$10.50 for an AP check.

The Lucas Group's recommendations would help ensure that only those Michigan claimants actually eligible would receive benefits. They would also ensure that UIA performs its work efficiently – and at the most appropriate cost. The recommendations in Table 1 work together to propose a new model for UI administration that could be a national example of efficiency. The savings would arise primarily from:

- Eliminating “overpayments” – which are payments UIA makes because processing is so slow
- Finding and prosecuting fraud beyond the instances now reported by outside whistleblowers
- Labor savings from more efficient operations
- Requiring a one-week waiting period before collecting unemployment

These recommendations would provide the additional benefit of encouraging claimants to more actively pursue their job search, which would increase employment and further decrease the UI rolls.

Table 1: Lucas Group Recommendation Summary

Recommendation	How this will save Michigan Employers/Taxpayers	Potential for Annual Savings*
1. Pursue fraud and abuse more proactively	Capture fraud not now detected. On average UI agencies recover 2% of claims as fraud, Michigan's recovers less than 1%	\$30-50 MM
2. Eliminate the "pay and chase" approach to claims management	Eliminate overpayments, which are instances in which UIA pays claimants benefits they never were eligible for, but takes as much as a year to resolve	\$60-80 MM
3. Tie UI more closely to work search activities to get claimants back to work	Michigan benefits in two ways: (1) fewer weeks of claims benefits, and (2) employees get back to work, strengthening the economy	\$30-40 MM
4. Revise non-monetary eligibility requirements to be closer to national best practices	Savings found by: revising seasonal worker definitions, gross misconduct, and requiring claimants to accept employment offers reflective of the current job market	\$30-50 MM
5. Revise monetary eligibility requirements	Savings found by making fewer weekly benefit payments	\$80-100 MM
6. Create a new, quality management approach to managing claims	This is fundamental to many of the other recommendations. In addition to improving quality, it should reduce cost of administration	\$50-70 MM
7. Compute benefits on 52 weeks rather than highest quarter	Avoid claimants receiving high benefits because of seasonal peaks in pay	150-250 MM
Overall Annual Savings Potential		\$350-550 MM

* Saving potential not completely additive, because the recommendations support each other

2 UI Program Assessment

Financially, UIA performs poorly compared to other transaction processing organizations, such as other state UI agencies, other state agencies that perform similar transaction processing and commercial organizations' transaction processing costs.

2.1 High Cost of UI Program Administration

Compared to other states UI operations, Michigan is high cost. Federal Department of Labor (DOL) allocates an administration budget to each state through costing standards based on the "minutes per unit" (MPU) specifically calculated for each state, based on its unique policies and processes. In 2010, federal standards based on their observations of UIA processes, allocated Michigan \$121 million in administrative costs (Table 2). However, Michigan actually spent \$181 million, \$60 million more than DOL calculated it should have. In addition, because of Michigan's unique UI processes, their MPUs are higher than average US states. If Michigan used processes that were equal to the average efficiency in US states, their costs would have been \$4 million less in 2010.

Table 2: Analysis of Federal Allocation Budget and Michigan Actual Administrative Expense, 2010

Function	Budget Factors		Federal Budget Allocation		Potential Savings
	Michigan MPU	US MPU*	Federal Budget for Michigan	Michigan Recalculated	
Initial Claims	36.52	26.95	17,512,196	12,930,000	4,580,000
Weeks Claimed	1.16	1.74	3,939,110	5,880,000	(1,940,000)
Non Monetary	26.83	49.36	8,315,899	15,300,000	(6,980,000)
Appeals	273.08	220.84	6,234,732	5,040,000	1,190,000
Wage Records	0.16	0.17	2,426,398	2,720,000	(290,000)
Tax Functions	75.78	64.82	14,210,246	12,160,000	2,050,000
Support	0.27	0.19	19,120,090	13,310,000	5,810,000
Other			49,724,506	49,720,000	0
Federal Budget for MI			121,483,177	117,060,000	4,420,000
Michigan Actual				181,170,000	
Variance (unfavorable)				(64,110,000)	
Total Potential Savings					<u>\$ 8,850,000</u>

* US MPU calculated from total US data Source: Lucas Group analysis of DOL data

Comparing UIA to Medicaid is justified because both state agencies establish eligibility, verify on-going eligibility, and process many transactions based on eligibility. Medicaid claims are different in many respects. However, federal Medicaid rules limit reimbursement for state program administration to 5% of benefits paid. In Michigan, Medicaid administration reportedly amounts to 2% of total expenditures¹. In contrast, Table 3 shows that UIA total administrative costs are 7% (Table 3). Were UI managed with only 2% or even 5% of benefits flow, UIA savings would have been \$50 million and \$130

million respectively (compared to 2010 actual costs of \$181 million). Accordingly, in our recommendations, we include \$50-70 million potential savings resulting from using quality management practices to drive out cost.

Table 3: Michigan UI Administrative Costs Analyzed, 2006-2010

	2006	2007	2008	2009	2010
Total UI Administrative Costs (\$ millions)	\$135.33	\$130.71	\$136.82	\$172.02	\$181.17
Admin Costs/Benefits Paid (incl. federal)	6.9%	7.1%	6.1%	4.1%	7.1%
Admin Costs/First Claim Payment	\$294.80	\$300.02	\$266.57	\$263.50	\$442.97
Admin Costs/Claim Check	\$19.41	\$20.21	\$17.83	\$13.58	\$21.98

Source: Lucas Group analysis of data provided by UIA

Comparing UIA to a commercial company's Accounts Payable (AP) department is justified because they both set up new claimants (i.e. vendors) and process many transactions per claimant. As with UI claims, each line on each invoice must be verified – assuring the payer company received the goods. This is analogous to determining the claimant meets the on-going eligibility requirements. The benchmark cost of an AP check is \$10.50²; the average cost of processing a UI claim in Michigan is \$20 (Table 3). Were UIA as effective as a typical commercial AP department, 2010 savings would have been \$86 million.

2.2 Process that Relies Heavily upon Claimant Integrity

Michigan no longer has hard evidence from most claimants that they meet the ongoing requirements for UI eligibility. Though the rules are complex, they boil essentially to six questions, the three most verifiable are: (1) are you actively seeking work; (2) are you available for work; and (3) have you refused work? Every claimant is required by UI law to meet these criteria each week for which benefits are claimed. Many years ago, Michigan collected hard evidence in the form of names of employers contacted, and so forth. Instead, today Michigan has come to rely exclusively on web and phone input from claimants both to file an initial claim and monitor on-going eligibility. While some other states (e.g. South Carolina) require periodic visits to a workforce center and hard evidence of job search for nearly all cases, Michigan collects “yes” and “no” answers to a series of questions to claimants on its phone or web system. Michigan's approach involves the least human interaction with claimants of all states, and is lower than what is required for federal extensions. Relying heavily on self-reported information leaves Michigan exposed to serious issues of fraud and abuse. To verify accuracy, UIA conducts audits using the Federal Benefit Accuracy Management (BAM) and Eligibility Review Program (ERP) processes. These require UIA to look at fewer than 1,000 files – out of 8 million annual checks. When they audit these files, they correct issues found on those files, and have no on-going, rigorous method for determining and correcting systemically the underlying root causes for errors found.

2.3 Weak Timeliness and Accuracy Compared to Outside Standards

UIA measures its own performance as shown in Table 4. This suggests two important findings. First, UIA performs below its own minimum acceptable quality standards in several dimensions. UIA

completes only 27% of its appeals within its target of 40 days. Second, from the perspective of an outsider, do UIA's minimum performance thresholds seem reasonable? For example, outsiders might not accept 40 days as the target for completing appeals. Federal UI rules require that claimants be paid pending appeal; this means that 22% of claims that are appealed are exhausted (26 weeks) before the appeal is resolved. DOL and UIA rules aside, this does not seem reasonable. Following the same logic, would a reasonable person expect a transaction processing organization to perform accurately at an 92.8% level. Motorola's accounting department by comparison makes only one error in a million opportunities to make an error (Six Sigma). It seems that UIA holds itself to a very modest standard of performance (and cannot meet that level).

Table 4: Michigan Performance Measures, December 2010

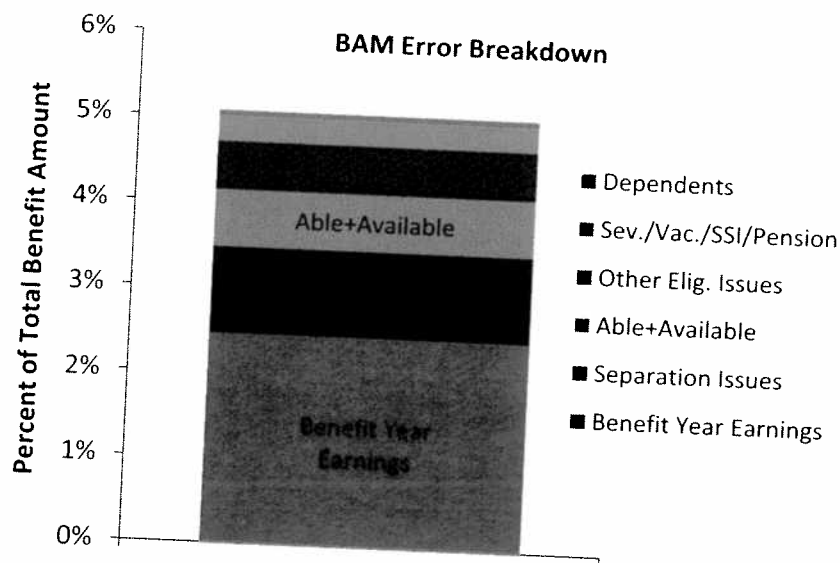
Performance Dimension	Minimum Acceptable Performance	Current Performance
First Payment with 14* days after the end of the first compensable week	87%	84.5%
Average Age of Claims Pending Higher Authority Appeals	40 days	27% of open cases have been open fewer than 40 days. 22% have been open for longer than 180 days
Average Age of Claims Pending Lower Authority Appeals	30 Days	63.9% have been pending longer than 40 days
Nonmonetary Determination Quality — Initial Claims	75%	74%
Nonmonetary Determination Quality — On-going Claims	75%	93%

* 21 days if state has a one week waiting period

Source: Lucas Group analysis of UIA data

In addition to reporting internal performance standards, UIA tracks and reports DOL's Benefit Accuracy Management (BAM) standards. In December 2010, Michigan's BAM data Summary Error Rate was 7.21% versus a US average of 9.29%. This comparison would seem like Michigan is doing well until you compare it to Motorola's Accounting Department, which has achieved Six Sigma since the mid 1990's and has an error rate of 0.000001%. In order to reduce errors, UIA must understand what caused the errors. DOL requires UIA to break down errors by what it calls "causes" (Figure 4). However, this is not the level of granularity required for root cause analysis.

Figure 4: BAM Errors by Type, Michigan, 2009



Source: Lucas Group analysis of DOL data

One might conclude that UIA is operating within normal UI agency performance levels. However, from an outside perspective, these represent surprisingly poor performance. According to DOL data, 7.21% of the amounts paid for the individual claims audited were in error. More specifically, UIA pays 5.07% in claims that are later determined to have been invalid. UIA has very little luck recovering overpaid claims dollars from unemployed people. The “fraud rate” represents those fraudulent claims that are caught – but UIA has no estimate of the actual instances of fraud. Given the fraud detection methods we observed, this low rate could mean that UIA is not finding as much of the fraud as other states.

The data suggests that DOL-based fraud detection methods are finding that 7% of payments are leaking to overpayments, errors or fraud. Based on 2010 benefits expenditures, this could have amounted to \$150 million in 2010 and \$250 million in 2009.

2.4 Further Opportunity for Finding and Correcting Systemic Quality Issues

To find and correct instances of fraud and abuse, Michigan follows the quality control practices required by federal Department of Labor (DOL) – and its DOL quality rates are among the best using that standard. Notwithstanding, Michigan UI practices are not designed to effectively manage against fraud and abuse. DOL requirements are significantly weaker than what any commercial organization would use to manage a multi-billion transactions flow. DOL requires that Michigan sample only less than one percent of cases. Furthermore, Michigan does not use root cause analysis to extend its quality findings. Michigan’s Unemployment Agency (UIA) has taken only first steps toward computer-assisted data mining to search for potential fraud and abuse. Instead of using sophisticated data mining and software for finding fraud, nearly all of the cases UIA investigates are identified by outside whistleblowers.

Finding something that is not there can be challenging and raises the question: How can The Lucas Group know for sure that UIA has no ongoing quality management process? We asked the two departments within UIA, as well as the UIA Director to confirm that the organization lacks the key elements of quality management. We did not find:

- Metrics of the frequency of underlying causes for errors found through audit
- Staff assigned to work regularly with rank-in-file workers to develop new processes (we were told that these are developed by internal analysts)
- Dash board information regularly reviewed by management and staff to track effect of systemic process changes
- A quality manual or program
- Universal access to process descriptions and a mentality of strict process adherence

Instead, we were told that errant claims were fixed, and the office generating them was alerted so that the responsible individual could be appropriately disciplined. That approach is antithetical to quality management.

3 Recommendations to Reform Michigan's UI Program

Given that (a) Michigan already has higher taxes than average, (b) average benefits are comparable to other states, and (c) internal performance metrics suggest low administrative performance; a first step toward a healthier UI program will be to improve key aspects of UI operations. The program needs to be reformed in six major ways. Below, The Lucas Group recommends specific programs that could be implemented to affect the needed reforms.

Categories of Change Recommended:

1. Pursue fraud and abuse more proactively
2. Eliminate the "pay and chase" approach to claims management
3. Tie UI more closely to work search activities to get claimants back to work
4. Revise non-monetary eligibility requirements to be closer to national best practices
5. Revise monetary eligibility requirements
6. Create a new, quality management approach to managing claims

3.1 Pursue Fraud and Abuse More Proactively

Nearly all of the UI program abuse the Agency currently investigates is identified by outside whistleblowers. Recently, UIA began the process of implementing a computer-based data mining tool to find fraud and abuse on its own. However, they built the system in-house, without the benefit of commercially available tools and experience. Consequently, after six months of effort, UIA has implemented a single "rule". In contrast, fraud detection systems in other environments use sophisticated tools to develop and manage hundreds of rules.

According to the US Government Accounting Office (GAO), the leading cause of UI fraud and abuse is claimants who returned to work, yet continued to claim UI benefits.³ This is a frustratingly difficult source of fraud to discover. To address it, Michigan's UI program matches claims with data from employer reports, a quarter later. Thus, finding this leading cause of fraud could require three months or more to discover. That is half of the state's maximum claim period.

Based on the national level of fraud recovery of 2% compared to Michigan's 0.76% recovery rate, either Michigan's processes are so solid they invite less fraud, or Michigan is failing to recover fraud. Since Michigan's fraud detection system currently relies mostly on whistleblowers, we must conclude that aggressive data mining, tighter verification rules and inviting employers to participate more could close the gap nationally. In addition, the GAO reports that fraud in UI is at least 4%. Accordingly, The Lucas Group recommends implementing aggressive fraud controls to increase fraud detection and recovery an additional 2% of total benefits payments, or \$30-50 million annually. Table 7 details our recommendations.

Table 5: Fraud and Abuse Recommendations

Title	Description	Implications/Rationale
Make it easy for employer to report bad job searching behavior	UIA could create a web/phone ability for employers to report bad job searching behavior. Employers could be asked to report anyone who turns down an offer of work or misses a recruiting appointment. Computer software could search through the reports to match against UI rolls	Employers want to encourage job seekers not to abuse recruiting resources. No shows and turn downs add workload to recruiting teams. These reports would have no effect on applicants not claiming UI. This change can be made administratively or legislatively.
Expand Benefit Accuracy Management (BAM) or Eligibility Review Program (ERP) Audits	Today, UIA conducts a few hundred BAM and ERP audits annually. Their error rate of several percent is acceptable by DOL standards. However, DOL standards are not based on Quality Control (QC) standards that commercial companies follow. This recommendation would take the next step toward understanding the real issues with claims	In the world of commercial quality control, BAM and ERP error rates would will cause a manufacturer to reject a whole production lot (i.e., UIA should look in detail at every case). This recommendation would require UIA to do what a commercial company would have to do; test more cases to better understand the real error rate. This change would not require legislative action but could be linked to efforts to implement fraud detection software.
Expand data mining rules	Expand beyond the single "rule" now used for data mining to dozens or hundreds of rules. These rules should be developed from root cause analysis of BAM/ERP audits and the experience of other states. This might be best supported with third-party software	As UIA has realized, fraud detection is ideally supported by data mining applications. UIA has developed an internal application to review historic claims for possible fraud situations. UIA should have dozens of such rules, based on quality findings, past denials, appeals, and recoveries. This change would not require legislative action but could be linked to efforts to implement fraud detection software.
Implement commercial fraud detection software	Implement commercially available UI fraud detection software such as OnPoint or Lexis/Nexis. This could provide data on the potential benefit of procuring software or services	UIA has developed its own tools for fraud discovery. Unfortunately, this approach is not ideally suited for taking advantages of best fraud practices in other states, and other industries. Legislation could be passed to require the state to pursue commercial fraud software.
Require a child care plan	If the claimant makes claims for dependents, then the claimant must provide a child care plan – with names that can be audited	This would provide UIA with a method of verifying that a claimant actually has the ability to quickly line up child care in the event a job comes up. This change can be made administratively or legislatively.

3.2 Eliminate “Pay and Chase”

Today, UIA frequently cannot complete the required investigation of a claim’s merit in the required time. Like most other states, Michigan follows a practice called “pay and chase.” That is, pay the claim; continue the investigation, and then attempt to recover the payments if the claim is later found not to be by the facts. Eliminating pay and chase would make Michigan a national “best practice”. This could be accomplished by revising claim processing so that claims and appeals are resolved within the federal maximum time requirements – before any claims are paid. Currently all other states pay claims that are not fully resolved. However, that is an artifact of the program; it is not a requirement. Other industries are successful at quickly evaluating and verifying transactions that are even more complex than UI, making the decision before paying the money. One good example is home mortgage approvals, which used to require weeks or months, and are now completed in minutes. Imagine a bank paying out a home mortgage or car loan first, then trying to recover the funds for a large percentage of loans that still had open issues at closing. Unthinkable.

The need for pay and chase arises because UIA does not complete its claim verification before federally-mandated requirement that claims be authorized within 21 days of the end of the first week the claimant would be eligible for payment.

If the claim is not settled at the end of the 21 days, then UIA must begin paying the claim. In the event that the claim is later disallowed, the amount paid out is termed “overpayment.” This is not fraud, in that the claimant never hid the facts – there was a legitimate issue that had to be resolved through appeal. UIA has limited ability to collect these funds. Usually, they collect nothing unless it is as a reduction of future UI claims.

UIA is forced to “pay and chase” because it uses antiquated, paper based, reactive process to verify claims. Some have estimated that 50% of work done by services organizations such as UIA is wasted time⁴. UIA should not compare itself to other UI agencies, as they all seem to use ineffective processes when compared to private-sector standards. UIA has no internal group that is responsible for working on a regular basis to find and eliminate delays. In industry, a widely respected method for finding and eliminating time delays is LEAN. Examples of the benefit of applying LEAN to transactions processing abound. For example, Lockheed Martin (already an efficient company) reduced the time to process a purchase order by 40%. The steps for applying LEAN to UIA’s operations are laid out in Michael George’s “Lean Six Sigma for Service.”⁵ They include:

- Assessment
- Creating Pull
- Mobilization
- Performance and Control

Today, appeals are an especially egregious part of the UI process; they require many repeated meetings involving claimants, UIA staff, and appeals personnel. This is fundamentally a poorly designed system which violates the principle of quickly determining eligibility. UIA might start quality management efforts by eliminating time delays in appeals.

UIA can significantly reduce the time required to fully adjudicate eligibility by using the LEAN method. Some examples of changes UIA might find useful as they improve process include:

- Encouraging (or requiring) employers to complete UI eligibility as part of the employees exit process
- Reducing the time employers have to verify claim accuracy – to 2-3 days
- Employing an email or web-based system instead of paper mail in all aspects of the process
- Re-designing the appeals process so that all appeals are heard by the second level – no need for two levels of appeal
- Further clarifying the rules – so that there are fewer instances requiring judgment
- Appeals initiated on line, automatically scheduled for a few days later, conducted by phone (as they are now), including all parties with decisions being final
- Eliminate the first appeal – going directly to an Administrative Law Judge. Prepare case in a sufficient manner and plan hearing calendars so that (consistent with the right to a speedy trial) claimants are not dragged through a multi-month process

Only through careful root cause analysis of the data will UIA be able to find ways to eliminate bottlenecks, delays, duplication, lost files, and the other reasons that now cause overpayments.

Savings will come from reducing the amount of overpayments based on appeals. According to Agency report to DOL, these amounted to \$275 million in 2009 and \$150 million⁶ in 2010. Based on this, The Lucas Group recommends that Michigan could target reducing the 2010 number by at least half: \$60-80 million. This would represent merely reducing pay and chase, not eliminating it. UIA should set as the target to complete every claim through appeal before making payment. Table 8 details our recommendations.

Table 6: Pay and Chase Recommendations

Title	Description	Implications/Rationale
Require that UIA must fully adjudicate all claims before making any payment	This is a fundamental change in the rules. In order not to violate federal rules, this may require that claims be done within the federally-required time limits. This should NOT be done by expanding staffing, rather by engineering the process so that it happens more quickly. It may include linking employers in by phone or video conference. The tools of TQM, LEAN and six sigma are ideally suited for reducing process time	UIA gets itself in trouble by paying first, then collecting later, if the claim is not valid. If UIA used process improvement techniques, and altered data flow, it could process claims to completion in days, not weeks. Banks used to take weeks to approve a home mortgage which they now approve in minutes. There is nothing in the claim processing job that requires weeks to complete. This change would require legislation.
Create an appeals process that is real-time, interactive and eliminates delays	Objective: put everyone together at once, with a clear-cut set of rules, and make a decision	Eliminate pay and chase. This change would require legislation.
Shift more of the burden to the claimant	UIA could require claimants to play a more significant role in chasing down employer information	This aligns incentives more correctly. The claimant is the one who benefits from gathering employer data. This change would require legislation.
Add teeth to collection of overpayments	Overpayments happen when a claim is paid, and later found to be inappropriate because the person failed to report wages earned, was discharged from employment for just cause, was trying to defraud the system, etc. Today, UIA mostly collects these overpayments by withholding a portion of a subsequent claim, if and when one is filed. UIA does not garnish wages for non-fraud overpayments.	The objective is to give the state strong ability to attach wages, lottery winnings, bank accounts, tax refunds, etc. This change would require legislation.

3.3 Tie UI More Closely to Work Search Activities

UIA should develop a new contract with claimants. It should provide more specific guidance about the nature of the job search required to qualify for UI, provides better tools to support job seekers, and hold them accountable for following the prescribed steps. The federal UI program, and state law, requires that claimants be available for and actively seeking work. However, there are not clearly defined steps for an acceptable job search. In addition, the state collects virtually no data on the steps that claimants are taking toward finding a job. As a result, UIA verified the job search for only a few hundred weekly claim payments out of 8 million checks written in 2010⁷. Arguably, this is a primary role of the Agency.

Some other states tie UI payments more closely to their workforce activities for two reasons. First, it encourages claimants to consistently pursue employment. Second, it is a method for identifying claimants that do not comply. Many states deny weekly payments for claimants that refuse to follow the program.

Savings from this initiative will derive from those two impacts. Neither is easy to identify without testing and monitoring new approaches. However, both www.monster.com and www.jobs.com list thousands of open jobs in Michigan. There are unfilled jobs today that UI claimants could apply for. Through experimenting with different approaches and tracking their impact, UI (together with Michigan Works) could help get more claimants back to work and off the UI rolls. If merely 1% of claimants could be helped back to work, the savings to UI benefits would be \$30-40 million (1% of 550,000 claimants * 300 AWBA * 20 week average claim). In addition, employers would pay another \$3 million in UI taxes on these employees. The real benefit, of course, is that these people are back to work – putting bread on their own table and strengthening the Michigan economy. Table 9 details our recommendations.

Table 7: Recommendations to Tie UI More Closely to Michigan Works

Title	Description	Implications/Rationale
Require claimants to report details of job search activity	Require claimants to report specific steps they took to look for work, along with corroborative contact information. UIA would verify on a sampling basis	Today, UIA accepts claimants, representation they are looking for work, without a common understanding of what it means to be meeting the requirement. This would ensure that claimants at least have something to support their claim of looking for work – and that UIA has something to test. This change could be made through legislation.
Require claimants to provide a job search plan	Require every claimant to have a job search plan that spells out what they plan to do, and when, to find employment. This could be a free-form document claimants would provide and update. Or, Michigan's Automated Response Voice Interactive Network (MARVIN) could provide tools to develop and maintain the plan. Failure to comply could be defined as failing to make adequate effort	UI could require that claimants use the tool in order to be declared to be "searching for work". This would ensure that job search is in some way organized, not just random efforts. Some claimants may not be able to use a web tool but could be channeled to Michigan Works local offices. This change could be made through legislation.
Specify acceptable job search steps	State UI law could define the specific acceptable steps that a person must be taking to look for work. This could be simply a list. Alternatively, the list could give weights to various activities, and require a total number of points. This list would be developed by Michigan Works in conjunction with Economic Development and with recruiting experts	This would provide UIA a specific cause for disallowing a claim. Today, UIA does not have an unambiguous way of defining an acceptable search. Consequently, it has little to either disallow a claim, or to identify claimants that are not conducting an effective search. This change could be made through legislation.
Require a minimum number of job search activities	UIA could establish a standard for minimum number of job search activities in a week. This compares to many years ago when a claimant had to present a form documenting a certain number of job interviews	This improves UIA's ability to both disallow a claim for inadequate search activity, and to identify claimants that are not conducting an effective search. This change could be made through legislation.
Require documentation of job search activities	UIA could require that claimant submits some form of documentation supporting that she met the minimum number of activities. This could be screen shots of visits to a job bank, letters, or the	Today, UIA has no documentation to support a claimant's job search. This would provide a trail of activity that UIA could monitor for substance (i.e. count of documents or automated document analysis). In addition, it

Title	Description	Implications/Rationale
	contact information and time of an appointment. UIA could automatically count these, and audit them on a sampling basis. Advanced software could identify contact information for verification	could provide a source of information for UIA to audit and test compliance with the rules. This change could be made through legislation.
Eliminate the "attached worker" provision program or limit use to positive balance employers	Today, some employers can declare that a worker who has been laid off will be recalled. This "attached worker" need not look for replacement work in order to claim UI benefits. The recommendation is that all workers must look for work in order to claim on the UI program	This would redefine UI to prevent employers from using it as a form of compensation during low work periods. It would also encourage employees to avoid discovering many weeks after being laid off that they are not going to be recalled – and only then starting a job search. This change could be made through legislation.

3.4 Revise Non-Monetary Eligibility Requirements

Michigan rules for eligibility are weaker than many other states. Policymakers should review Michigan's rules to those of other states, and adapt Michigan's own policies accordingly. A key area is misconduct. Section 29(1) (b) of the Michigan Employment Security Act provides that if a worker is fired from a job due to misconduct that occurred in connection with the work, then the worker will be "disqualified" from benefits. The worker must then get another job and have earnings with that employer to "re-qualify" for benefits. But the employer from whom the worker was fired will not be charged for the benefits, even if the worker re-qualifies and draws benefits.⁸ In Michigan a claimant guilty of misconduct may have benefits postponed for 17 weeks. This is one of the harshest penalties compared to other states. However, some of these claimants are guilty of "gross misconduct". First, several other states are more clear about what will be considered gross misconduct. It appears that Michigan asks the appeals process to determine that. Table 10 describes how other states treat gross misconduct, compared to Michigan.

Table 8: Gross Misconduct Definition in Selected States

State	Gross Misconduct Definition
Maryland	Aggravated misconduct, which is defined as behavior committed with actual malice and deliberate disregard for the property, safety or life of others that: affects the employer, fellow employees, subcontractors, invitees of the employer, and members of the public or the ultimate consumer... ⁹
New Jersey	A new bill (A3707) Has three levels of misconduct: simply, severe and gross. ¹⁰
Vermont	Examples include, but are not limited to theft, fraud, intoxication, intentional serious damage to property, intentional infliction of personal injury, and conduct that constitutes a felony, or incidents after written warning of either unprovoked insubordination or use of profanity ¹¹
South Carolina	Failure of a drug test, theft of over \$50 from an employer, insubordination, reckless damage of more than \$50, assault and battery on another employee, consumption

State	Gross Misconduct Definition
	of or being under the influence of alcohol on employer property in violation of written company policy ¹²

Second, Michigan has lower penalties for gross misconduct. Michigan can disqualify that employer's earnings from the claimant's earnings base and reduce benefits for 13 weeks. Other states have stronger rules about gross misconduct in two respects. Table 9 compares the penalties for gross misconduct in Michigan to several other states. In the strictest states, claimants guilty of gross misconduct lose all of their previous earnings that would qualify them for UI. In Kansas, applicants must earn at least 8 times the average weekly benefit amount (after losing historic earnings) in order to qualify. In several states, the claimant is barred from receiving benefits for 12 months.

Table 9: Benefits Impact from Gross Misconduct (WBA=weekly benefit amount)¹³

State	Loss of Wage Credits	Work Requirement	Benefits Postponed
Michigan	Only from that employer	In each of 13 weeks, earnings at least 1/13 of previous high quarter, or File a claim for 13 weeks, even though the claimant cannot receive benefits!!!!	13 weeks
Colorado	All wage credits cancelled		26 weeks
Idaho, Illinois, Indiana, Iowa, Nebraska, Oregon	All wage credits cancelled		
Kansas	All wage credits cancelled	Earn at least 8 * WBA after termination	
Arkansas, Florida, Montana, New York, North Dakota, Utah			12 months

Table 10 details our recommendations concerning various areas of non-monetary determination. In total, these represent \$30-50 million of potential savings.

Table 10: Non-Monetary Eligibility Recommendations

Title	Description	Implications/Rationale
Increase the number of employers eligible for "seasonal" designation	UIA and Michigan Works act together to identify seasonal employers (other than construction) and make sure they are registered as a seasonal employer. Analyze if industries such as retail, that hire and let go of employees seasonally, should be labeled as seasonal employers. The Michigan Employment Security Act states that if a seasonal employer (excluding construction) can give reasonable assurance of re-turning to work next season, those employees will not have the right to file for UI benefits, unless the employee loses his/her job in season or the job is not returned in the subsequent work season	A seasonal employer designation to give "reasonable assurance" of work to employees for the next season. Seasonal employers need to follow the UIA guidelines for seasonal designation. By expanding the number of industries and companies that qualify and register for seasonal designation, certain types of employers may be able to maintain a lower unemployment tax rate. This change would require legislative action.
Change the definition of suitable work as a claimant's duration collecting UI benefits continues	Today, claimants are not required to accept employment below 70% of their historic earnings. This could be redefined in light of Michigan's changing economy. As a UI claimant has received a defined number of weeks their definition of suitable work as defined by previous wages should be broadened. For example, at 12 weeks a claimant must not turn down work that is 60% of their historic earnings or they would lose benefits. In fact, Maine no longer considers a claimant's prior wage in determining whether work is suitable at 12 week of receiving benefits.	By changing how suitable work is defined based on a claimant's duration, it would have 2 primary impacts: 1) the claimant would have more urgency to seek a job similar to their historic wage, and 2) they would be required to take a job that may not pay what they are used to, but they would no longer need to receive UI benefits. This change would likely require legislative action.
Increase disqualification period employees fired for gross misconduct : 52 weeks, and lose all previous earnings	Make disqualification period for acts of misconduct or gross negligence more penalizing. This issue is covered by Section 29(1) (b) of the Michigan Employment Security Act. The Act provides that if a worker is fired from a job due to misconduct that occurred in connection with the work, then the worker will be "disqualified" from benefits. State courts have held that to be	Michigan disqualifies an employee from receiving benefits for 26 weeks. The worker must then get another job and have earnings with that employer to "re-qualify" for benefits. The most rigid states deny benefits for 52 weeks as well as having claimants get another job and have a threshold of earnings with that new employer before being eligible for UI again. Increasing the period of disqualification would produce a

Title	Description	Implications/Rationale
	misconduct, the actions by the worker must be harmful to the interests of the employer, and must be done intentionally or in disregard of the employer's interests. Actions that are grossly negligent will also be considered misconduct. A single incident of misconduct or of gross negligence may be enough to disqualify a worker from unemployment benefits. A worker who commits many infractions may be disqualified, even if none of the infractions, alone, would be misconduct resulting in disqualification. However, the final incident in a series, for which the worker is fired, must itself show an intentional disregard of the employer's interests.	savings and deterrent for potential future acts of gross misconduct. This change would require legislative action.

3.5 Revise Monetary Eligibility Requirements

Michigan's economy has changed. The benefit calculation multipliers and limits need to keep abreast with the economic reality of a globalizing economy. The crisis Michigan UI now faces affords a unique opportunity to refine the program and put it on a sounder footing going forward. The basics of benefit calculation are an employee's historic earnings. The multipliers define how those earnings are used to calculate each claimant's weekly benefit amount and the number of weeks that may be claimed. Of the many equations and multipliers that could be revised, four are most impactful.

Savings from this recommendation would be from making fewer weekly benefits payments by implementing a one week waiting period. Forty other states require a waiting period, including Indiana, Illinois and Ohio.

Michigan's average claim duration is 20 weeks. Thus only about half of claimants reach the current maximum of 26 weeks. Those who do reach the maximum would not be affected by a waiting period. Those who do not would lose a week of benefits. Thus, The Lucas Group estimates savings at \$80-100 million ($550,000 * 0.5 * \$300/\text{week}$). Table 11 details our recommendations.

Table 11: Monetary Eligibility Recommendations

Title	Description	Implications/Rationale
Implement waiting week	Require claimants have a one week waiting period after filing their initial claim and before receiving their initial benefits	Most other states (40) have a one week waiting period. By adding a week waiting period the Michigan could save a week of benefits for all claimants that do not use the current maximum 26 weeks. Recently, the Kansas Senate passed a plan to reinstate the one week waiting period for benefits, which has existed in Kansas since the 1930s but was lifted in 2007. ¹⁴ This change would require legislative action.

3.6 Implement Quality Management

Today, UIA uses an approach to quality control that would not be useful in any other transaction processing industry. Following the approach required by federal DOL, UIA looks at a few hundred (out of millions) of claims annually. The errors found on individual test samples are corrected, but UIA has no rigorous, ongoing program to use the findings to make systemic changes correcting the underlying root causes. This is in sharp contrast to which Michigan's commercial employers and employees, who have all become very comfortable with quality management, such as Total Quality Management or "TQM"¹⁵, Six Sigma¹⁶, and Lean production (LEAN)¹⁷.

One national example of a quality management system is used by Ford Motor Company, "DMAIC". This is an acronym for the steps in the process to conduct the program¹⁸

- Phase 1 – Define: Clarify the purpose and scope of improving the process, build a basic understanding of the process to be improved, and determine the stakeholder's (e.g. claimants and employers) perceptions and expectations for quality. Goal: Ensure that the stakeholders are all on the same page.
- Phase 2 - Measure: Define and measure current processes in order to fully understand both how and how well they work. Create a detailed process map, gather baseline data, and summarize and analyze the data. UIA has considerable data about system throughput, errors and delays. This will help UIA build a continuous improvement approach to managing quality.
- Phase 3 - Analyze: Identify potential root causes for the process problem being addressed and then confirm actual root causes with data. Today, UIA routinely focuses on correcting individual errors, and identifying personal responsibility. These steps are not related to analyzing root causes for the purpose of correcting systemic process issues.
- Phase 4 - Improve: A DMAIC or other quality management program must be conducted through the people who are involved in performing the process, not by analysts. Their input regarding potential improvements is critical for brainstorming potential solutions, assessing options, designing and communicating the solutions.
- Phase 5 - Control: The key is to monitor impact of the changes (NOT the people) to ensure that the gains obtained during Improve are maintained. To that end, a quality-managed organization standardizes and documents procedures, makes sure all employees are trained and

communicated the project's results. In addition, a quality-managed organization has an on-going plan for monitoring processes and reacting to problems that arise over time.

Much has been written about applying a combination of LEAN and Six Sigma to the government sector¹⁹. US government operations widely adapted some form of quality management twenty years ago, including the Army²⁰, Navy (who coined the term TQM)²¹, Air Force²², NASA²³, Agriculture²⁴ and others. Some form of TQM is strongly supported by US Government Accounting Office for government agencies. Which quality management approach UIA adopts is less important than that it adopts one.

Savings from a quality management system will show up in every aspect of UI program management: faster more accurate cases at lower cost. No one can know for sure what UIA might achieve. However, the benchmarks offered above suggest that UI processing (in Michigan as well as other states) can experience substantial improvement. At a minimum, Michigan could target achieving the DOL allocation standard, a savings of \$64 million (see Table 6). However, even this standard is based on practices Michigan already uses. Thirty years ago, Ford Motor Company applied quality management principles to its AP department (we made the case for comparison above) and both increased timeliness and accuracy, and reduced staff from 500 to 5 people. Thus, Lucas Group's estimate of \$50-70 MM in savings is viewed to be conservative.

Table 12: Quality Management Recommendations

Title	Description	Implications/Rationale
Introduce quality management	For each Benefit Accuracy Management (BAM) or Eligibility Review Program (ERP) finding, identify the root cause of the finding, and document that in a manner that will allow for subsequent Pareto analysis. Root causes could be specific types of UIA error, or particular types of employer error, misunderstood forms. UIA would develop corrective action plans to address root causes, and track metrics.	Identifying root cause is will involve following up with claimants or employers. Today, UIA has no information about frequency of root causes. Current quality practices (a) fix error in the individual audited cases, and (b) identify the person (office) responsible. This change can be made internally by the UIA.
Sponsor a states quality conference	Convene a conference of leading states' quality auditors to collaborate on developing an ongoing process for finding the leading root causes of fraud and abuse – both claimant and employer	Michigan has limited window into the leading edge work other states are doing with computer applications, data mining, predictive modeling and staff skills. Some states are eager to learn from their peers: Michigan could provide a forum – possibly in conjunction with thought leaders such as NASWA, NASBO or UWC Strategy. This change can be made internally by the UIA.
Develop a quality management steering committee	Convene a steering committee including representatives of quality functions within Michigan employers. This team would be responsible for working with UIA to develop a new quality management approach to managing claims processing. The committee would report to an appointee of the governor (outside UIA) to ensure that UIA responds appropriately to the committee	Today, UIA operates without a working knowledge of the latest in quality management techniques used in other process-intensive organizations. These include banks, insurance companies, manufacturing firms, and even state Medicaid. UIA could draw on their knowledge and experience. This change can be made internally by the UIA.
Build a team of quality management analysts	Develop a team of claims analysts that are responsible for reviewing and analyzing the results of BAM and ERP audits, developing new rules for data mining, and following-up on findings. A team of 6 to 8 well-qualified people might be justified by the magnitude	UIA has quality auditors. In addition, it needs a team skilled and equipped to implement the quality management capabilities described above. This change can be made internally by the UIA.
Report improvements to	UIA should be asked to report improvements in quality	UIA has many dedicated leaders and workers, who have inherited a system

Title	Description	Implications/Rationale
policymakers	management directly to a senior appointee of the Governor and/or the Legislature. This should be done at least annually	and processes that lack modern capabilities. Reporting outside would encourage them to look beyond DOL rules to take on the challenge of improving UI to the expectations of the outside world. This change can be made internally by the UIA.

3.7 Compute weekly benefits on average, not highest weekly history earnings

Michigan could reduce benefits substantially by calculating weekly benefits amount based on average rather than highest quarter earnings. Across the country, states use three methods for computing claimants' weekly benefit amounts²⁵. Implicit in all three methods are two long-standing UI principles: (a) The weekly benefit amount should be directly related to the individual's usual wage, and (b) the benefit generally should replace 50 percent of wages. The three methods include:

1. Computing the weekly benefit as a fraction of the claimant's wages in that calendar quarter on the base period in which wages were highest (employee's high quarter). Michigan uses this formula today; competitor states, including Indiana and Ohio, do not.
2. Computing the weekly benefit using an average weekly wage formula to compute the weekly benefit as a percentage of the claimant's average weekly wage.
3. Computing the weekly benefit using an annual income formula to compute weekly benefits as a percentage of the total wages the claimant earned during the base period.

Michigan's current method (high quarter formula - #1, above) is applied to determine the amount payable to the claimant for each week of unemployment in the benefit year. It is applied as follows:

$$\text{Weekly Benefit Amount} = \text{Highest Quarter Wages in the Base Period} \times 4.1\% \text{ (capped at \$362)}$$

One negative effect of using the high quarter formula is that unemployment claims charges for employers in industries with cyclical unemployment are even higher using the high quarter formula. Furthermore, the differential between the higher weekly benefit amount and wages for suitable work available off-season is smaller or non-existent, discouraging claimants from being available for work and extending unemployment claim durations. The current method allows for one quarter of high wages to skew the weekly benefit amount and results in higher charges for industries with cyclical unemployment.

Michigan should consider using an annual income formula (#3, above) to compute weekly benefits for new claimants entering the system. The weekly benefit amount would be calculated by dividing a claimant's earnings during a year (regardless of how many weeks s/he worked) by 52. This method was recently adopted by Indiana. Indiana estimates, based on a 2008 sample of about 230,000 claims during the year, the change would reduce benefit expenditures by about 25%. Indiana made the change to increase more fairness of weekly benefit calculation. It provides a person who earned, for

example, earned \$40,000 over four quarters to collect the same amount of weekly benefits as the person who earned \$40,000 in one quarter. This change would not affect the maximum weekly benefits that could be awarded (maximum of \$362).

4 Study Method

This report was conducted during the period December 2010 through February 2011. The findings were developed by The Lucas Group under contract with the Michigan Chamber of Commerce. The Chamber gave The Lucas Group considerable latitude to consider many different alternatives – there is no agenda behind this report, other than surfacing the issues as a foundation for policy discussions.

Accordingly, The Lucas Group takes full responsibility for the method, findings and recommendations. The consultants are grateful to the Chamber for its vision in studying this critical issue, and for the courage to commission a “no holds barred” study.

5 About The Lucas Group

During times when public policymakers are forced to choose between slashing budgets and raising taxes, governments are constantly challenged by an environment that demands exceptional accuracy as well as high quality, exemplary customer service. The Lucas Group has built a reputation as experts that will help optimize government programs with cost-effective results.

The Lucas Group leverages its commercial strategy and government program experience to recommend solutions that help governments reach their objectives, despite the ongoing economic crisis. Our Government Solutions Team has a proven track record of delivering results for states, counties and municipalities across the country. We have experts who have played critical roles in and out of government, and who have helped shape government services. We find new efficiencies and identify savings opportunities without impacting critical services, and we help establish innovative public/private partnerships that meet the unique needs of beneficiaries. In the past, we have led a number of assignments in such areas as restructuring an entire department of health and human services, reforming employment programs, including welfare-to-work, modernizing eligibility systems, and developing other strategies for policy reform. Our Government Solutions Team remains committed to achieving positive results for all of our government clients.

Jay Lucas, Managing Partner

Dr. William J. Oliver, Partner

Endnotes

- ¹ Michigan Executive Budget Fiscal Years 2012 and 2013
- ² http://www.cassinfo.com/frt_payment_cost.html
- ³ Improper Payments: Progress Made but Challenges Remain in Estimating and Reducing Improper Payments, 2008, Testimony of Kay L. Daly, <http://www.gao.gov/new.items/d09628t.pdf>
- ⁴ George, M. L., & George, M. (2003). Lean six sigma for service: McGraw-Hill New York, NY.
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- ⁶ Estimated by Lucas Group, DOL numbers are not yet available
- ⁷ According to DOL, 8,242,207
- ⁸ http://www.michigan.gov/uia/0,1607,7-118-26831_27122_27127-78538--,00.html
- ⁹ Highlights of State Unemployment Compensation Laws, National Foundation for Unemployment Compensation and Workers Compensation, 2010, p92
- ¹⁰ <http://www.businessmanagementdaily.com/articles/5851/1/New-Jersey-Unemployment-Compensation-Law/Page1.html#>
- ¹¹ <http://www.labor.vermont.gov/Portals/0/UI/reformemployer.pdf>
- ¹² <http://www2.wjbf.com/news/2010/nov/06/sc-unemployment-law-changes-mean-no-benefits-gross-ar-1059478/>
- ¹³ Highlights of State Unemployment Compensation Laws, National Foundation for Unemployment Compensation and Workers Compensation, 2010, p92
- ¹⁴ Kansas Senate Majority Leader Jay Emler, February 21, 2011
- ¹⁵ TQM is a business strategy that functions on the premise that the quality of the products and processes is the responsibility of everyone who is involved with the creation or consumption of the products or services offered by the organization. In other words, TQM capitalizes on the involvement of management, workforce, suppliers, and even customers, in order to meet or exceed customer expectations
- ¹⁶ Six Sigma is a business management strategy that seeks to improve the quality of process outputs by identifying and removing the causes of defects (errors) and minimizing variability in manufacturing and business processes
- ¹⁷ LEAN is a business production practice that considers the expenditure of resources for any goal other than the creation of value for the end customer to be wasteful, and thus a target for elimination.) over the past 30 years
- ¹⁸ <http://www.brighthub.com/office/project-management/articles/23947.aspx#ixzz1EuB3d3b7>
- ¹⁹ http://www.xerox.com/downloads/wpaper/f/FILE_GSIN_XGS_WHTP_LSS_PSECTOR.pdf
- ²⁰ <http://www.armyobt.army.mil/>
- ²¹ <http://www.gao.gov/products/GGD-93-29R>
- ²² <http://www.af.mil/news/story.asp?id=123019761>
- ²³ http://ntrs.nasa.gov/archive/nasa/casi.ntrs.nasa.gov/19930010749_1993010749.pdf
- ²⁴ <http://www.gao.gov/products/GGD-93-16R>
- ²⁵ UWC, Highlights of State Unemployment Compensation Laws 2009, page 59)

